IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-873

ARTHUR ANDERSEN & CO.,
Petitioner,

v.

STATE OF OHIO, THE HONORABLE SHERMAN G. FINESILVER, UNITED STATES DISTRICT JUDGE, *et al.*,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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January 20, 1977

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OPINION BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit, not yet reported, is printed in petitioner's Appendix B.

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition.

QUESTIONS PRESENTED

1. Whether a party objecting to an order to produce documents on grounds of foreign legal prohibitions may obtain appellate relief when the trial court has yet to rule finally either on the foreign law objections or on the matter of possible sanctions for failure to produce?

2. Whether a party may assert foreign anti-disclosure laws as grounds for refusing to comply with discovery orders without first showing that it has exerted in good faith every effort to comply by means which would not violate foreign law?

STATEMENT OF THE CASE

A. Overview of the Factual Background: A Continuing Discovery Dispute

This petition arises amid the fourth phase of a still unfolding pretrial discovery controversy. The litigation was commenced in 1972 by respondent State of Ohio ("Ohio"). Following a series of stays and other events which postponed significant discovery until late October 1975, Ohio requested production of documents and information, including certain materials in the Geneva, Switzerland office of defendant-petitioner Arthur Andersen & Co. ("Andersen"). For seven months Andersen resisted Ohio's discovery requests on various grounds.

The second phase of the dispute began in April of 1976 when Ohio moved for an order compelling production of certain of the documents it had been seeking. (Appendix A, p. 20). Andersen resisted the order, and five more weeks of extensive and detailed briefing ensued. This phase ended in late May of 1976 when the court granted Ohio's motion to compel during a hearing on several outstanding discovery matters.

There followed a third phase of the controversy lasting about seven weeks. The court, which had not immediately entered a detailed order governing the mechanics of production, was successively urged by Andersen to withdraw its initial order, to modify it, and then to delay its implementation. During this phase the court twice postponed the deadline for compliance; in later, more detailed orders it modified its initial ruling by directing Andersen to exert every effort to produce documents as to which Andersen asserted its inability to comply due to Swiss law.

The fourth phase has yet to conclude. It arose in connection with what Andersen called its "voluntary" or "good faith" efforts at compliance. In mid-July of 1976 Ohio moved for sanctions on the grounds that a good faith effort to comply had never been made by Andersen and was not then being made. The trial court has yet to rule finally either on Ohio's motion for sanctions or on Andersen's contentions under Swiss law. In late July the court postponed for a third time the deadline for Andersen's compliance. Andersen appealed the initial order to the United States Court of Appeals for the Tenth Circuit; it appealed each subsequent order, and it filed a petition for a writ of mandamus.

The nine volumes of the record on appeal in the Tenth Circuit include more than 800 pages of briefs, transcripts and memoranda setting forth the rather elaborate factual background and legal contentions of the parties. On December 1, 1976, the Tenth Circuit dismissed the interlocutory appeals, finding that Andersen had not made a sufficient factual showing to merit appellate intervention in the ongoing discovery process. It added: "When and if a subsequent order of the court imposes a harmful sanction, that order may then be reviewed." The Tenth Circuit also found that the challenged orders usurped no power, and denied Andersen's petition for mandamus.

Because the Tenth Circuit's refusal to intervene in the discovery in this case rests expressly upon the absence of an adequate factual premise, and as the "prerogative writs" also turn decisively upon the circumstances of each case, Ohio sets forth below in greater detail facts which Ohio believes are essential to this Court's consideration of the petition.

B. The Background in Pertinent Detail

Ohio's allegations against Andersen in this case relate to Ohio's purchase in the Spring of 1970 of $8 million in securities of King Resources Company ("KRC"). The securities were never redeemed, and KRC subsequently filed a petition in bankruptcy.

In purchasing the securities, Ohio relied upon financial statements of KRC audited by Andersen, and upon Andersen's unqualified opinions that those statements fairly presented the financial position of KRC. Ohio asserts that those statements did not fairly present KRC's financial position in that, among other things, they failed to disclose the extent of KRC's dependence upon a principal customer, failed to disclose that the customer was approaching financial collapse, that KRC had embarked on a costly and risky attempt to take control of and rescue its principal customer, and that the principal customer was The Fund of Funds, Ltd. ("F.O.F."), a nonresident offshore Canadian mutual fund controlled by Investors Overseas Services, Ltd. ("I.O.S."), another nonresident Canadian corporation.

F.O.F. and I.O.S. maintained their principal offices in or near Geneva, Switzerland. Both had been forbidden by a 1967 Order of the Securities and Exchange Commission from doing business within the Commission's jurisdiction. Both were audited by Andersen.

Documents pertaining to Andersen's audit services for I.O.S. were requested from Andersen on October 24, 1975. During the next seven months Ohio and Andersen exchanged numerous pleadings and memoranda respecting Andersen's objections to the discovery. The trial court monitored the controversy and intervened where necessary, frequently emphasizing its concern that both the moving party and the objecting party must present a proper factual foundation for all discovery motions. On December 16, 1975, for example, the district court told Andersen:

> "The Court is satisfied that there must be more particularity as to why there are any privileges, and the Court, without making this a law of the case or the rule of the case, is satisfied that the broad generalities of any foreign secrecy laws are not very persuasive at this point . . . Again, any claims of foreign law prohibitions are to be made

> with specificity. The Court directs the answers should be complete and responsive."

"Reporter's Official Transcript of Court's Ruling of December 16, 1975," p. 6.

When Ohio received Andersen's objections to the motion to compel and the opinion of Andersen's Swiss lawyers, Ohio responded in two ways. First, Ohio immediately contacted the major entities whose consent would, according to the opinion, assist in effecting production of the documents at issue. By this means, Ohio obtained consents from representatives of The Fund of Funds, Ltd., I.O.S. Growth Fund, Ltd., and FOF Proprietary Funds, Ltd. Andersen replied only that these "purported" consents might well be invalid, and that the court could afford them no weight unless Andersen's Swiss lawyers assented.

Second, Ohio responded with a new proposed order replacing that attached to its initial motion to compel. The new order included a provision specifically directed to documents whose production Andersen believed would violate Swiss law, requiring only that as to such material Andersen "exert every effort" to obtain any required consents so as to comply with Swiss law. (Appendix B, p. 34).

On May 26, 1976, the district court having reviewed the factual proffer made by Ohio in its motion to compel and having reviewed the briefs filed afterwards, declared:

> "Item No. 3, Discovery of certain items held in Andersen's Geneva office. This was originally filed on the 15th of April, 1976. Later filings were on that same day, the 30th of April, and the 10th of May. We recognize that our original order was that discovery was to be limited to the continental United States. We are satisfied that the plaintiff has made a good showing for the discovery of these items in the Geneva office, and we accordingly grant the discovery of these documents held in Andersen's

> Geneva office. We will impose no sanctions in regard to this item."

"Reporter's Official Transcript of Proceedings Held May 26, 1976," p. 9.

Three more weeks passed. Andersen produced none of the requested material. Instead it asked the court to withdraw the May 26 order, arguing that it had been "caught by surprise" and needed more time to consider the "ramifications" of the order. It also advised the court that it now desired to determine the effect of the consents supplied by Ohio, which it had previously rejected out of hand.

The trial court's response was to call upon Ohio and Andersen to meet together in a spirit of "professional concern and cooperation" to try to agree upon a modified procedure that would resolve the dispute. The court stated that it would then entertain a joint motion respecting such a modified procedure. Before the meeting ordered by the court could be held, Andersen appealed the May 26 order.

After Andersen's appeal, Ohio met with Andersen twice in attempts to seek a modified procedure. At both meetings Andersen flatly refused to agree to any order that would require it even to "exert every effort" to effect production of documents from its Swiss offices. Ohio independently submitted such an order to the trial court. Andersen offered its own proposed order. On July 2, the trial court withdrew its initial order and essentially adopted Ohio's proposal—an order that Andersen "exert every effort" to produce. The order also stated that if on July 16 any documents were still withheld, Ohio and Andersen were to confer in an effort to resolve their differences.

One week before such a conference was to be held, however, Andersen appealed that July 2 order. It also advised the trial court that *for the first time* its lawyers had actually reviewed the documents in its Geneva office. The lawyers reported there were only 220 documents which pertained to

Ohio's requests and that Andersen would produce what it described as the "responsive portions" of 190 of those documents in the week of July 12.

The week of July 12 passed. No documents were produced. Instead Andersen delivered to Ohio a "protective order" to which it required Ohio's agreement before production of what Andersen referred to as the "redacted" documents, even though these concededly contained no "business secrets." (One such "redacted" document is appended hereto as Appendix C, p. 36).

On July 15, Ohio finally asked the court to impose sanctions for the reason that the pattern of bad faith on Andersen's part had now become unmistakable. On July 16, the court set a hearing on the motion for July 22 at 1:30 p.m.

Until 10:30 a.m. on the morning of July 22, no documents were produced. At that hour Andersen delivered its first tangible response to Ohio's requests and the court's orders: a five-page document containing no business secrets and responding to interrogatories originally filed by Ohio in December of 1975, a list of documents which Andersen refused to produce, and 80 newspaper clippings. (One of the clippings is reproduced as Appendix D, p. 38). At the hearing that afternoon, the court criticized Andersen's insistence on a protective order before submitting answers to Ohio's interrogatories. Andersen conceded this had been unnecessary. (Appendix E-1, p. 40). The court also demanded to know why Andersen had withheld until that morning documents it knew to contain no business secrets. Counsel for Andersen replied that he was "not focusing" on delay as being a problem. (Appendix E-2, p. 41). At the conclusion of the July 22 hearing, the court stated:

> "I think that the balance in regard to lack of cooperation weighs heavier on the one side than the other and, of necessity, I have to say that Arthur Andersen's position in some respects is not borne

> out by some of the pleadings or some of the observations or some of the chronology of events in this case."

"Reporter's Official Transcript of Proceedings Held July 22, 1976," p. 82.

The court, however, imposed no sanctions; it indicated its reluctance to do so, and stated that it would take that matter under advisement. It then directed both parties to meet concerning the unproduced documents and it set another hearing for the next morning. At that hearing the court postponed for the third time, to August 19, the deadline for Andersen's compliance with Ohio's discovery requests. Even should Andersen on that date continue to withhold documents, the court stated that it would, if necessary, appoint an expert in Swiss law to give testimony concerning Andersen's Swiss law claims.

On August 4, however, before the conference suggested by the court could be held and 15 days before the newly extended compliance date, Andersen appealed the July 23 order.

Presently Andersen continues to withhold approximately thirteen documents, together with numerous "portions" of documents which it edited on grounds of "relevance."[1] The court has expressed its disapproval of Andersen's prior editing of documents (Appendix E-3, p. 41). Following discussions between Ohio and Andersen, Andersen has produced the complete versions of some of this previously "redacted" material. Almost all of the documents recently produced have come from what Andersen identifies as "non-Geneva" sources, *i.e.*, sources as to which Swiss secrecy could never have been a relevant or proper objection. Andersen has offered no explanation of why it did not long ago turn to its "non-Geneva" sources for the documents it claims to have tried so hard to produce.

[1] On January 7, 1977, Andersen informed Ohio that it had obtained the consent of I.O.S., pursuant to which it "expects" to produce during the week of January 10 all but two of the withheld documents, together with additional portions of documents which it previously produced in edited form.

On January 14, 1977, Andersen informed Ohio that the withheld documents which it had expected to produce during the week of January 10 had been mailed from Geneva on January 13 or 14 and would be produced during the week of January 17. Additional portions of documents previously edited by Andersen were offered to Ohio subject to a protective order, to which Ohio agreed.

ARGUMENT

I. AS THE OPINION OF THE TENTH CIRCUIT EMPHASIZES, THIS CASE IS NOT RIPE FOR REVIEW, SINCE THE "ISSUE" UPON WHICH ANDERSEN POSITS ITS NEED FOR APPELLATE INTERVENTION REMAINS OPEN AND UNDECIDED IN THE TRIAL COURT

Andersen's brief leaves no doubt as to the issue upon which its petition rests: the opinion below, Andersen says, improperly "requires" Andersen either to disobey a federal court order or else to violate Swiss law:

> "Andersen, meanwhile, is inextricably *caught between the Scylla of obedience with Swiss law/disobedience of the court's orders and the Charybdis of disobedience of Swiss law/compliance with the court's orders.* Andersen's position simply is that an order which places a defendant in such a position is contrary to law." [Emphasis supplied].

Andersen's Petition, p. 11.

Andersen repeats this contention in less colorful terms not once or twice but nine more times. (Andersen's Petition, pp. 3, 4, 5, 7, 9, 10, 13, 15, 16). But the argument, and the petition, must fail, for as the district court recognized, and as the Tenth Circuit has affirmed, Andersen's "dilemma" is precisely as mythical as Scylla and Charybdis.

As for Andersen's "Scylla," Andersen may by appropriate means obtain appellate review of a contempt sanction (but not of its own ironic speculations as to how and why it

might be held in contempt for what the trial court *may* eventually decide Andersen has failed to do). That is the common sense thrust of the *Alexander* doctrine which has governed the appealability of discovery orders in the federal courts for more than 70 years:

> "Let the court go farther, and punish the witness for contempt of its order—then arrives a right of review, and this is adequate for his protection without unduly impeding the progress of the case."

Alexander v. *United States*, 201 U.S. 117, 121 (1906). See also, *United States* v. *Ryan*, 402 U.S. 530 (1971).

As for the supposed "Charybdis," nobody is requiring Andersen to violate Swiss law. If sanctions are imposed it will be because of Andersen's bad faith, not simply because certain documents were not produced. But the fact is that it has never suited Andersen's appellate purposes to acknowledge that a door is open to it in the trial court. Thus, when Andersen cites the court's insistence that August 19 or 20 must be the deadline for Andersen to produce the documents or else show why it cannot do so, Andersen omits the court's equally firm statement that it will still be willing to consider proper expert testimony concerning any Swiss law objections as to documents not produced. The following is the final paragraph of the court's statement as cited by Andersen in Appendix L of its petition. The material *after* the asterisks is a part which Andersen "redacts":

> "I am not enamored with the approach to Swiss law taken by Defense Counsel. However, this period of time will no doubt, I'm sure, produce these documents. The Court is withholding the appointment of an expert in Swiss law to come over from Switzerland who is versed in Swiss law and American law to give testimony on this point. I do not want to add to the cost of litigation of five or ten thousand dollars at least and go to a peripheral issue on 25 documents.
>
> • • •

> "However, there's no question that this Court will go on this tack if there's still any contention that these can't be produced under Swiss law because I very well feel that under the preliminary research that this Court did there's an unusually rigid approach being taken by Swiss Counsel in regard to what the implications are of that law and Counsel for Arthur Andersen would be well advised to read some of the Tenth Circuit cases dealing with Swiss law."

"Reporter's Transcript of Proceedings Held July 23, 1976," pp. 32-33.

Ohio has submitted to the trial court that Andersen has not responded in good faith. Andersen has asserted the contrary. Until the factual disputes underlying these claims are ruled upon by the trial court, based on the detailed record with which it is most familiar, Andersen's petition must remain just as amorphous as the present posture of the dispute.

In *Kerr* v. *United States District Court for the Northern District of California*, ___ U.S. ___, 48 L.Ed. 2d 725 (1976), this Court recently had occasion to consider the application of mandamus in the context of a pretrial discovery controversy, which it found to be unresolved and unripe. Reaffirming the critical requirement of finality in the federal appellate system, the Court stresses the fact that the district judge in *Kerr* "apparently left open the opportunity for petitioners to return to the District Court, assert the privilege more specifically and through responsible officials, and then have their request . . . reconsidered in a different light . . . ." 48 L. Ed. 2d at 733. The *facts* of the present discovery controversy, not Andersen's tale of Scylla and Charybdis, show that far from having pursued all other adequate means of obtaining the relief which it sought, it was, and it still is Andersen's practice to seek interlocutory remedies well before exerting ordinary, let alone ex-

traordinary efforts to attain its declared objective, *i.e.*, protection from asserted adverse consequences of disclosure under Swiss law. Because Andersen's petition, as that of *Kerr*, is fundamentally defective respecting the requirement of ripeness, the petition should be denied.

II. NO CONFLICT AMONG CIRCUITS IS PRESENTED BY THE CASES CITED BY ANDERSEN; INDEED, SEVERAL OF THOSE CASES OFFER SIGNIFICANT SUPPORT FOR THE OPINION BELOW

Andersen asserts that until the trial court entered the orders in this case "all relevant judicial precedent in this country supported Andersen's position." (Petition, p. 11). For this proposition it cites without analysis or factual summary five Second Circuit cases, quoting three sentences from two of them.

The problem here is not to refute Andersen's statement; rather, it is to respond concisely to an assertion that is wrong and misleading in such panoramic fashion. When one actually examines what those cases hold, and the facts upon which they rest, there is no conflict, either of law or of fact, between any of them and the opinion and judgment of the Tenth Circuit in this case.

Trade Development Bank v. *Continental Insurance Co.*, 469 F.2d 35 (2d Cir. 1972), affirms a district court decision not to compel production of documents revealing the identity of Swiss bank account holders; the case is not pertinent here because the trial court had specifically ruled, as the appellate court observed, that the material sought by the moving party "is not a relevant issue in the case," 469 F.2d at 40. Here, on the contrary, the district court found after extensive briefing by both parties that Ohio had "made a good showing" for the requested documents, and it has

adhered to that view through many months of Andersen's delay and outright defiance.[2]

Nor does *First National City Bank* v. *Internal Revenue Service*, 271 F.2d 616 (2d Cir. 1959), *cert. denied*, 361 U.S. 948 (1960), conflict with the opinion of the Tenth Circuit in this case. On its *facts* the case simply holds that the discovered party, again a New York bank, failed to make a sufficient showing that it would incur any penalty under foreign law by complying with a government subpoena. In *dictum*, the Second Circuit observes that if in fact production of records would "require" violation of Panamanian law, production should not be ordered. As noted, this matter remains open in the present case. In the same case, the Second Circuit also imparts some advice to which Andersen understandably does not refer:

> "If the Bank cannot, as it were, serve two masters and comply with the lawful requirements both of the United States and of Panama, perhaps it should surrender to one sovereign or the other the privileges received therefrom . . . ."

271 F.2d at 620.

In *United States* v. *First National City Bank*, 396 F. 2d 897 (2d Cir. 1968), the Second Circuit firmly upholds a civil contempt sanction against a New York bank which

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[2] Both in the Tenth Circuit and now in this Court Andersen has misleadingly cited in its memoranda the trial court's use of the word "peripheral" in comments from the bench at the July 23, 1976 hearing. The term occurred in the court's statement that it wanted a firm deadline for compliance, that it would appoint a Swiss law expert, but preferred if possible, not to increase unnecessarily the cost of litigation. (See Andersen's Appendix L). As Ohio pointed out in the Tenth Circuit, the district court has never said the documents were peripheral to the *issues*. It has ruled to the contrary. But, incredibly, Andersen again has the trial court saying that the discovery is peripheral to the case. (Petition, p. 14, footnote). Andersen's effort to distort the trial court's words and turn them against that court can hardly fortify its petition.

failed to comply with a subpoena for production of documents possessed by its branch in Germany. The opinion underscores the trial court's finding of bad faith on the part of the New York bank for failure to examine the records whose production it resisted. Similarly in this case, Andersen repeatedly and stridently asserted its imminent jeopardy and proffered the opinion of its Swiss lawyers, which it has now included in the appendix to its petition—all before any of Andersen's lawyers, American or Swiss, had even bothered to review the documents sought by Ohio. Unlike *First National City Bank*, there has been no ruling by the district court here on the crucial matter of bad faith.

Application of Chase Manhattan Bank, 297 F.2d 611 (2d Cir. 1962), affirms the trial court's modification of a subpoena for records of a Panamanian branch of a New York bank. The opinion notes that the modification was proper in order to avoid the "necessity" of violating foreign law. In the present case the trial court has already declared its willingness to entertain a proper showing that foreign law rather than tactical self-interest has prompted Andersen's resistance.

Ings v. *Ferguson*, 282 F.2d 149 (2d Cir. 1960), the last of Andersen's five cited cases, is completely inapposite to Andersen's claim. There the appellate court's expression of concern for the effect of a discovery order involving foreign documents is specifically directed to a foreign non-party witness ordered to produce its documents in this country.

> "Under these circumstances it seems highly undesirable that the courts of the United States should countenance service of a subpoena upon a New York agency of a foreign bank which is not a party to the litigation and whose country has provided procedures for securing information, the production of which is consistent with its laws."

282 F.2d at 152.

Andersen is no bystander here. It can scarcely argue that it is entitled to whatever special consideration may be due to a foreign non-party witness.

As Andersen points out, the Tenth Circuit has noted some of the cases and commentary which criticize the reasoning of the early Second Circuit opinions to the extent which that reasoning departs from *Societé Internationale* v. *Rogers*, 357 U.S. 197 (1958). What Andersen ignores, what is manifest upon comparison of any of those cases with the present one, and what undermines Andersen's petition is that on the facts which are actually before this Court, not the events hypothesized by Andersen, the Second Circuit cases present no conflict.

III. NO NOVEL OR SUBSTANTIAL QUESTION DISTINGUISHES THIS CASE, WHICH FALLS SQUARELY WITHIN THE PRINCIPLES ESTABLISHED BY THIS COURT IN *SOCIETÉ INTERNATIONALE* v. *ROGERS*

It has been more than a year now since Ohio first requested documents from Andersen's Geneva offices. In that time, by one dilatory maneuver after another, Andersen has converted a Rule 34 request into an enormously expensive, time-consuming struggle which has finally brought this lawsuit to a standstill.

Always Andersen has excused its tactics of avoidance as a painful duty reluctantly but nobly performed in the service of various higher principles; higher, that is, than the Federal Rules. Most of these "principles" are collected in Andersen's petition. Sometimes Andersen cites "international comity." (Petition, p. 10). On other occasions it speaks of its concern for "the foreign operations of American firms," (Petition, p. 16), or it refers broadly to the "integrity of the domestic laws and public policies of foreign sovereign states." (Petition, p. 10). It has pointed

also to "the political and economic interests of the United States which are furthered by international trade and commerce." (Petition, p. 10). It has even relied upon the "state interest of Switzerland." (Petition, p. 6).

With due respect to these important causes, in this case they have never been anything but theater. As the Tenth Circuit said in commenting upon Andersen's asserted regard for "international comity":

> "If the problem involves a breach of friendly relations between two nations, Andersen should call the matter to the attention of those officers and agencies of the United States charged with the conduct of foreign affairs, and they could make such representation to the court as they deemed suitable. Andersen has not taken this action. Instead, it purports to speak for the United States." (Opinion of the Tenth Circuit, Andersen's Petition, p. 27).

One way of placing this case into perspective is to set it alongside *Société Internationale* v. *Rogers*, 357 U.S. 197 (1958), the leading case concerning the proper role of foreign law in controversies over production of documents. In *Société* this Court was confronted, first of all, with a fully ripened discovery dispute. The district court had dismissed the action of the plaintiff Swiss holding company for failure to comply with an order to produce documents in its Swiss offices. Speaking for a unanimous Court, Mr. Justice Harlan found a sanction as harsh as dismissal to have been unjustified because the company had unquestionably acted in good faith. The initial, unqualified order of the trial court to produce the documents was upheld, however, despite the fact that the documents were protected by Swiss law. This Court said:

> "Whatever its reasons, the petitioner did not comply with the production order. Such reasons, and the willfulness or good faith of petitioner, can

> hardly affect the fact of non-compliance and are relevant only to the path which the District Court might follow in dealing with petitioner's failure to comply."

357 U.S. at 208.

Thus the Tenth Circuit was correct in holding that Andersen or any litigant cannot avoid discovery "through the assertion of violation of foreign law." "Assertion" is the key word. For at the point where only the order of production, not the matter of sanctions for failure to produce, is at issue, the discovered party has not yet demonstrated that the documents are without its control. That is the absolutely fundamental matter which remains open and unresolved in the trial court in this case.

It is difficult to know what Andersen would make of *Société*. It claims to rely on the case. But it also presents in its petition a strained effort to distinguish *Société* on the grounds that the present case does not involve the Trading with the Enemy Act, and that here the discovered party is not a Swiss national. This effort cannot disguise the fact that the circumstances of the present discovery controversy are put in shadow by those which confronted the Supreme Court in *Société*.

1) In *Société* there was never any question of the good faith of the discovered party. The moving party, the Master appointed by the trial court, the trial court, as well as the appellate court all agreed that a good faith effort had been made. That question is very far from settled in this case. Ohio believes it will eventually be determined against Andersen.

2) The number of documents to be produced in *Société* was in the hundreds of thousands. By its own effort to obtain consents, the discovered party effected production of 180,000 documents. Here, when Andersen finally troubled to inspect its files in Geneva, it declared that only some

220 documents were responsive to Ohio's request. Forty per cent of these were news clippings, and 90 per cent of the other documents or the "responsive portions" thereof contained nothing secret.

3) In *Société*, the Swiss Federal Prosecutor not only expressed his government's interest in the case, but formally intervened by confiscating most of the documents subject to the district court's order of production. Here, despite Andersen's allusions to Swiss "state interests," not one Swiss official has ever expressed the slightest interest in this lawsuit.

The only extraordinary aspect of Andersen's posture here is the continuing unnecessary challenge to the authority of the trial court and the Federal Rules. On July 23, 1976, the district court said:

> "The problems on discovery, I'm satisfied, were brought about because Counsel—this is primarily Defense Counsel—for some unknown reason did not realize the spirit, the tenor of the Federal Rules of Civil Procedure as it relates to discovery.
>
> "The American court system has much resiliency, it has flexibility, but this system is going to come to a halt if we can't have the cooperation of experienced, professional attorneys . . . I dare say that our system is going to have some problems if we are going to stay afloat."

"Reporter's Official Transcript of Proceedings Held July 22, 1976," p. 59.

Ohio would submit that there are no questions in this case which merit review, and that in any event as the record now stands the appropriate sequel to the Tenth Circuit's opinion and judgment is the prompt resolution of this discovery controversy in the trial court.[8] Ohio believes that with the continued firm superintendence of the district court this can be accomplished, and that it must be accomplished, without further delay. The Tenth Circuit has very recently declared its similar conviction; on January 7, 1977 that court denied Andersen's motion to stay the mandate, saying:

> "The issue relates to an interlocutory discovery order. No sanction has been imposed for non-compliance. The case has been pending since April, 1972, and should go forward."

(Appendix F, p. 43).

[8] Although the mandate of the Tenth Circuit issued on January 10, 1977, none of the dire consequences predicted by Andersen has occurred.

CONCLUSION

For these reasons it is respectfully submitted that the petition should be denied.

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January 20, 1977

APPENDIX A

OHIO'S MOTION TO COMPEL, SUPPORTING MEMORANDUM AND PROPOSED ORDER, APRIL 15, 1976

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
M.D.L. DOCKET NO. MDL 79-1

In Re: STATE OF OHIO Plaintiff, vs. CROFTERS, INC. et al., Defendants	PLAINTIFF'S MOTION TO COMPEL FURTHER AND COMPLETE DISCOVERY, CONCERNING I.O.S., AND MEMORANDUM IN SUPPORT THEREOF

Plaintiff State of Ohio, pursuant to Rule 37 of the Federal Rules of Civil Procedure, moves this Court to compel defendant Arthur Andersen & Co. to provide further and complete discovery pertaining to two specific matters, as follows:

1. The first matter is contained in Request 26 of plaintiff's Second Request for Production of Documents, served on October 24, 1975. Request 26 sought production of:

> Reports of examination, draft reports, working papers, workpapers, correspondence files and permanent files of Andersen relative to examination after January 1, 1967 of IOS.

On December 16, 1975, this Court ruled that Request 26 was meritorious. Yet defendant has never produced, from its Geneva offices, any of the documents sought in Request 26. As will be more fully set forth in the attached memorandum, plaintiff has more than ample reason to believe that such documents exist and that they are directly material to

fundamental issues of this case. In order further to facilitate their prompt production, plaintiff now particularizes Request 26 as follows:

> Reports of examinations, draft reports, working papers, correspondence and news clipping files in the Geneva office of Arthur Andersen & Co. which reflect the decreasing cash flow and liquidity of IOS and its subsidiary Fund of Funds during the period from September 1, 1969 through May 31, 1970.

2. The second matter is contained in plaintiff's Interrogatories, Third Set, served upon Arthur Andersen on December 26, 1975, together with plaintiff's requests for production of documents therein identified. Interrogatory 73 of the Third Set stated:

> Did you at any time learn of agreements, negotiations, or any proposed agreements or negotiations to the effect that John M. King, KRC, or the Colorado Corporation, alone or in combination, through loans, stock purchases, or in any other manner, proposed to obtain control, ownership, or partial ownership or control of Investors Overseas Services?

Defendant answered, "Yes." Interrogatories 74, 78 and 79 of the Third Set then inquired about the circumstances under which this knowledge was obtained by Andersen, any investigatory steps taken by Andersen as a result of the knowledge, and any documents relating to such knowledge or investigation. Again, defendant has never identified or produced from its Geneva offices any such documents. Rather, defendant has maintained that it has already produced from its Chicago and Los Angeles offices all relevant documents. On March 30, 1976, this Court denied "at this time" plaintiff's motion to compel answers to these and other interrogatories in the Third Set. Plaintiff strongly believes that evidence of the existence in Geneva of documents directly material to Interrogatories 74, 78 and 79, as described

in the attached memorandum, requires that these interrogatories be fully answered and that *all* documents relevant to these interrogatories be supplied.

Wherefore, and for the reasons stated in the attached memorandum, plaintiff moves this court:

1. To compel defendant Arthur Andersen & Co. to produce fully and completely the documents sought in Request 26 (as further particularized and limited in this motion) of Plaintiff's Second Request for Production of Documents;

2. To reconsider and to compel defendant Arthur Andersen & Co. to respond fully to Interrogatories 74, 78 and 79 of Plaintiff's Interrogatories, Third Set, and to produce all documents identified in such responses.

Respectfully submitted,

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
M.D.L. DOCKET NO.—MDL 79-1

In Re: STATE OF OHIO Plaintiff, vs. CROFTERS, INC., et al., Defendants.	MEMORANDUM IN SUPPORT OF PLAINTIFF'S MOTION TO COMPEL FURTHER AND COMPLETE DISCOVERY CONCERNING IOS

I. THE INFORMATION AND DOCUMENTS WHICH PLAINTIFF SEEKS FROM ANDERSEN'S GENEVA OFFICE BEAR UPON ISSUES WHICH ARE BOTH CLEARLY FOCUSED AND CRITICAL TO THIS CASE.

Plaintiff's instant Motion requests documents relating to two key questions:

1) What did defendant Arthur Andersen know, before releasing its 1969 audit report for King Resources, about the seriously deteriorating financial condition of KRC's single most significant customer, Investors Overseas Services;

2) What did defendant Arthur Andersen know, before releasing its 1969 audit report for KRC, about urgent negotiations and plans by John King and KRC to take over control of the deteriorating IOS operations, at tremendous cost, and equivalent risk, to KRC?

Upon these questions in turn depend many of the other contested issues in this lawsuit. These relate not just to what Andersen knew by April 24, 1970, when it released its KRC audit, but what it should have *inquired* about *based* on

its knowledge, and what it should then have properly disclosed in its audit report to millions of present and potential investors who in early 1970 had themselves been reading confusing reports about the threatened IOS operation.

The accounting and financial issues in this case are often complex but certainly it takes no extensive accounting expertise to confirm that if Andersen knew, before releasing its 1969 KRC audit, that IOS was listing dangerously, then Andersen was required to make appropriate disclosures in its KRC report. Andersen *did* know that IOS was the biggest customer of KRC. Andersen *did* know that one IOS account, the natural resources account of Fund of Funds, accounted for at least one-fourth of KRC's total 1968 revenues, for more than one-third of KRC's total 1969 revenues, and for two-thirds of KRC's net profits in 1969. Andersen knew also that by year-end 1969 the investments of IOS itself in KRC and KRC entities amounted to $65 million. To that extent at least, as IOS went so went KRC. As of April of 1970, IOS was going sour. As the troubles of its president Bernard Cornfeld multiplied, and stockholders began dumping their holdings, IOS liquidity and cash flow had severely declined. When and to what extent Andersen became aware of these facts must be a decisive element in judging whether, as plaintiff contends, Andersen utterly defaulted on its obligation fairly and properly to audit KRC.

Similarly, it takes no insider's familiarity with KRC and its numerous entities to recognize that if Andersen knew, before issuing its 1969 KRC audit, that John King and KRC were actively negotiating for and planning to assume control, at enormous cost, of this fragile IOS empire, that knowledge should have been brought to bear on the 1969 KRC audit. In fact, in the 1969 audit there was not even a single mention of IOS. Plaintiff contends that Andersen had considerable knowledge concerning the projected takeover of IOS by KRC, and that Andersen did not employ what it knew either responsibly or, indeed, candidly in preparing its 1969 KRC report.

II. PREVIOUS DEPOSITION TESTIMONY AND EXHIBITS DEMONSTRATE UNAMBIGUOUSLY THAT THE DOCUMENTS AND INFORMATION WHICH PLAINTIFF SEEKS EXIST IN ANDERSEN'S GENEVA OFFICE.

A. Andersen's Geneva Office Knew of the Failing Financial Condition of IOS by April 24, 1970 When the KRC 1969 Audit Was Released

Request 26 of Plaintiff's second request for production is supported not simply by a common sense appraisal of what Andersen must have realized regarding IOS, an Andersen *client*, but on testimony and documents showing Andersen was in fact greatly worried by its knowledge. Three documents show Andersen's knowledge in graphic fashion.

First, on April 13, 1970, 11 days before Andersen's KRC report was issued, Allen Brodd, the accountant in charge of Andersen's Geneva office sent a memorandum from Zurich seeking assistance from the Chicago office. The Geneva office was, at that critical period which also preceded the release of the KRC audit, preparing the IOS report. Brodd told the Chicago office:

> We have unresolved many major problems which may require qualifications. Discussions of these matters are requiring my full time. The only manager here is Don Pearson who must return to Detroit Saturday. It is necessary that I have Martini for at least two weeks beginning Monday. Also, I will probably need Lynch for two weeks sometime later. I hope you will be able to work those out because this is an extremely critical period. I am sending this from Zurich where I have met with Tenz and Clavedetscher but neither can give me the help I need.
>
> I am sending a copy of this to March to keep him informed. We have already mailed copies of Lon-

> don newspaper reports. I have also kept John Rule and Dick Brandt in London fully informed.

Obviously this is no casual reference to a peripheral concern in Geneva. It is nothing less than an SOS signal.

The IOS account was in such serious difficulty that "qualifications" might be required in the report. This communication from Brodd could only have been based on the very Geneva documents sought by plaintiff's Request 26. In this context it is, at the least, disingenuous of Andersen to proclaim that all relevant documents have been produced from other Andersen offices.

Two days later, on April 15, 1970, Don Pearson, another accountant in the Geneva office, sent a telex to the Chicago office, which concluded:

> I am also enclosing copies of selected newspaper articles for your information. There are many rumors going around, each one a little more far fetched than the last. The sinking stock prices have shocked a lot of people at IOS and this might be of long range benefit to the Company.
>
> IOS management feels that the article from the London Sunday Times—April 12, 1970—is the fairest.

Thus Pearson had apparently raised the IOS publicity with IOS management, and had obtained their judgment as to which article was most accurate. Plaintiff is entitled to have these news clippings as well as all other documents which show what the Geneva office knew about IOS and when they obtained their information.

Finally, on April 16, still eight days *before* release of the KRC 1969 audit by Andersen, Mr. Brodd again communicated by telex from the Chicago office of Andersen. Brodd reviewed his discussion with Edward Cowett, with whom John King was then negotiating in order to obtain control of IOS. He noted:

> "we discussed the current 'Bear Raid' on the stock and he said that perhaps it had benefitted the company by forcibly reminding them they must keep a liquid position."

In sum, then, these documents show that in the two week period before Andersen issued its unqualified audit of KRC for 1969, Andersen's Geneva office was aware of a raid on the stock of IOS, KRC's largest customer; Andersen's Geneva office was collecting news articles about IOS's worsening plight, and the Geneva office audit of IOS had reached the point where a qualified report was in prospect. Plaintiff submits that its Request 26, as further defined in the instant Motion, is by any reasonable definition calculated to lead to the discovery of evidence of the highest relevance and materiality. On December 16, 1975, this Court granted Request 26. The Court said:

> "Request No. 26, as defined by plaintiff, the request is—the Court is satisfied that it's meritorious. The defendant Andersen is to produce all relevant documents in this regard whether in the Denver office or elsewhere." (Reporter's Transcript, Court's Ruling, p. 4.)

Prior to the Court's ruling, plaintiff had limited its request to the Denver, Chicago, and Los Angeles offices of Arthur Andersen. But plaintiff had expressly reserved the right "to seek inspection of documents on file in other offices should the need for this be uncovered during the course of the initial inspections." (Plaintiff's Motion to Compel Discovery and Certificate of Compliance with Local Rule 6(e), November 18, 1975, p. 5.)

Plaintiff submits that the above discussion amply demonstrates the need for production of documents from the Geneva office relevant to plaintiff's further refined Request 26.

B. Before Andersen Released the 1969 KRC Audit, its Geneva Office Not Only Possessed Information Concerning the Projected KRC Assump-

tion of Control Over IDS [sic] But Had Even Been Consulted by King Concerning His Negotiations.

As part of John King's plan to assume control over and revive IOS, KRC's troubled principal customer, King planned in early 1970 to purchase IOS stock then owned by the Edward Cowett family trusts and held by King as security for his loan to Cowett. That the Geneva office was in close touch with these negotiations is apparent in the April 16 communication from Allen Brodd in Andersen's Geneva office to the Chicago office. Brodd commented on his two-hour discussion with Cowett the previous day. He specifically noted that the KRC loan to Cowett had been discussed:

> We reviewed briefly financial holdings statements and he raised no objections at this time to specific disclosures. He said he would furnish us additional information with respect to the Cowett Family Trust and the King Trust. Both of these amounts are supported by substantial value in addition to IOS stock, he said, together with personal guarantees. I made the point that there were two parts to the question—one was the "subject to" on financial holdings statements and (2) the presentation on IOS Ltd. I said that if sufficient additional collateral were produced or there was solid evidence that the trust included other values which were not encumbered and were available to support the loan this could remove the "subject to" on financial holdings.

Problems connected with King's Geneva bank loans incidental to his planned purchase of IOS stock were also discussed with John King himself in some detail by Leonard Spacek, Chairman of Arthur Andersen & Co. Spacek's file memorandum of May 5 and May 6, 1970 reflects a conversation after release of the 1969 audit; nevertheless, the memorandum compels the conclusion that Andersen's knowledge

of King's plans concerning IOS was concrete, detailed and, for King himself, significant:

> I told Mr. King that the Bahamian Trust Funds, particularly the one for his family, become an important factor if King Resources is going to supply money to own IOS stock. This seems to me to put those funds and King Resources in a conflicting position, and he can't avoid the fact that it is related to him indirectly, if not directly, although he has no control. He said that that is one of the things to be done today; and that cash will be put into the bank by King Resources to take over the loans and all the IOS stock held as security will be purchased by King Resources as one of the steps, in addition to the $20 million being put into IOS directly with warrants to purchase additional stock. He also said that King Resources is taking over Cowett's loan to the bank and buying his stock at his cost, plus 25%, so that he and King's loan at Geneva bank will both be paid out. We should verify this as part of our December 31, 1969, audit and make sure that whatever disclosure is made conforms to the facts up to date.

King, says Spacek, cannot avoid the fact that as KRC takes steps to control IOS, IOS is "related to him indirectly, if not directly." Plaintiff is surely entitled to know the information which the Geneva office possessed and to examine documents in that office concerning the "steps" in the KRC plans to control IOS. Interrogatories 74, 78 and 79 specifically request what investigating steps were taken by the Geneva office respecting King's plans. Andersen has replied that no "services" were performed. This is evasive and inadequate. Allen Brodd's two-hour conversation with Edward Cowett demonstrates as much. Defendant should now be compelled to provide full and candid responses to these three interrogatories and to provide documents identified in such responses.

III. DEFENDANT ANDERSEN'S BROADLY STATED OBJECTIONS TO ANY DISCOVERY OF INFORMATION IN ITS GENEVA OFFICE ARE OUTWEIGHED BY THE MATERIALITY OF THE SPECIFIC INFORMATION PLAINTIFF SEEKS

To previous requests by plaintiff for the information and documents which are the subject of the present Motion, defendant Andersen has raised wholly undefined blanket objections of burdensomeness, Swiss secrecy laws, and the flat assertion that production from other Andersen offices must suffice.

Any merit defendant's burdensomeness objection may once have possessed must now be negated by plaintiff's presentation of only these few specific inquiries. In any event, burdensomeness lacks meaning unless compared with the weight on the other side of the discovery scales, the relevance of the discovery sought. Plaintiff submits that its showing of materiality as to the specific items in the present Motion far more than outweighs any burden of compliance by Andersen. Indeed, when called upon in 1968, 1969 and 1970 to serve the accounting requirements of John King's business entities around the world, Andersen found no serious obstacle to coordinating for King its own worldwide offices. Now, when plaintiff seeks to unravel some of the knots tied during those years, Andersen should not be permitted to raise these dubious obstacles, at least not without far more substantial grounds than have so far been presented.

Respecting Andersen's tenacious loyalty to the alleged demands of Swiss secrecy law, this Court stated on December 16, 1975:

> This Court is satisfied that the broad generalities of any foreign secrecy laws are not very persuasive at this point . . . if there is going to be any question of foreign secrecy laws, they are going to have to be specified with great particularity

> and specificity. This Court directs the answers should be complete and responsive. (Reporter's Transcript, Court's Ruling, p. 6.)

Defendant Andersen's secrecy claim is no less opaque now than it was four months ago.

Finally, Andersen's assertion that all relevant documents have been produced from its other branch offices, can hardly survive a recent collision with the representations of its own counsel:

> (Mr. Shaw) In order to clear up a possible misconception that might have been left as a result of some questions this morning, some questions were asked with regard to working papers located in Geneva. Through my own fault, I believe I may have, and through the nature of the questions to the witness, we may have given the impression that there are copies of all work papers of Arthur Andersen & Company located in Geneva and that such work papers would have copies located in one or more offices of the Andersen Company in the United States. That is not true. I did not mean to give that impression, and we would like to correct the record to that effect.
>
> • • •
>
> (Mr. Shaw) That is, the United States offices of Andersen & Company probably would not have copies of such papers located in Andersen & Company's office in Geneva; is that correct?
>
> (The Witness) That is right.
>
> (Mr. Shaw) That is all I had to say.
>
> (Deposition of Allen C. Brodd, Arthur Andersen & Co., January 26, 1976, pp. 67-68)

CONCLUSION

Plaintiff respectfully submits that the instant Motion seeks production of material which is specific, discrete, and patently relevant. Plaintiff requests the Court to grant plaintiff's Motion and to approve the attached proposed Order.

Respectfully submitted

OF COUNSEL:

HOLLAND & HART

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.....
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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
M.D.L. Docket No. MDL-79-1

C-4628

In Re:
King Resources Company Securities Litigation

STATE OF OHIO, Plaintiff, vs. CROFTERS, INC., et al. Defendants.	ORDER

This matter having come before the court upon Plaintiff's Motion to Compel Further and Complete Discovery Concerning I.O.S., and the court having considered the briefs of the parties,

IT IS HEREBY ORDERED, that Defendant Arthur Andersen & Co. shall no later than ....., respond fully and completely to Plaintiff's Document Request No. 26, as follows:

> Reports of examinations, draft reports, working papers, correspondence and news clipping files in the Geneva office of Arthur Andersen & Co. which reflect the decreasing cash flow and liquidity of I.O.S. and its subsidiary Fund of Funds during the period from September 1, 1969 through May 31, 1970.

IT IS FURTHER ORDERED, that Defendant Arthur Andersen & Co. shall, no later than .....,, respond fully and completely to Plaintiff's Interrogatories 74, 78 and 79 in Plaintiff's Interrogatories, Third Set, and shall include therein any and all pertinent information and documents in the Geneva offices of Arthur Andersen & Co.

.....
Sherman G. Finesilver,
District Judge

APPENDIX B

OHIO'S REVISED PROPOSED ORDER RESPECTING DOCUMENTS IN GENEVA, SWITZERLAND, MAY 10, 1976

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
M.D.L. Docket No. MDL-79-1

C-4628

In Re:

King Resources Company Securities Litigation

STATE OF OHIO, Plaintiff, vs. CROFTERS, INC., et al. Defendants.	ORDER

This matter having come before the Court upon Plaintiff's Motion to Compel Further and Complete Discovery Concerning IOS, and the Court having considered the contentions of the parties:

IT IS HEREBY ORDERED, that defendant Arthur Andersen & Co. shall, no later than _____, respond fully and completely to plaintiff's Document Request No. 26, as follows:

> Reports of examinations, draft reports, working papers, correspondence and news clipping files in the Geneva offices of Arthur Andersen & Co. which reflect the decreasing cash flow and liquidity of IOS and its subsidiary Fund of Funds during the period from September 1, 1969 through May 31, 1970.

IT IS FURTHER ORDERED, that defendant Arthur Andersen & Co. shall, no later than _____, respond fully and completely to Plaintiff's Interrogatories 74, 78 and 79 in Plaintiff's Interrogatories, Third Set, and shall include therein any and all pertinent information and documents in the Geneva offices of Arthur Andersen & Co.

[IT IS FURTHER ORDERED, that as to any documents or information the release of which defendant believes would subject it to civil or penal liability under Swiss law, the defendant shall:

1. Exert every effort to obtain the permission of the Swiss Government, or to obtain such consents or waivers as may be necessary to comply with this Order and with Swiss law;
2. Report to this Court no later than _____ concerning its compliance with this Order, including a summary of documents and information which have been produced, any items as to which defendant claims a privilege and has not yet obtained necessary permission or waivers, defendant's efforts to obtain such permission or waivers, and its plans respecting the production of such items.]

_____

Sherman G. Finesilver, Judge
United States District Court

APPENDIX C

ONE OF DOCUMENTS EDITED BY ANDERSEN BEFORE PRODUCTION TO OHIO, PRODUCED ON AUGUST 13, 1976

Remarks concerning I.O.S., Ltd. AHQ 12-31-69

1976-12

(21)

Comments concerning discussions with officers -

Finally, we had discussions with John King and his representatives.

1976-12

APPENDIX D

NEWS CLIPPING PRODUCED BY ANDERSEN ON JULY 22, 1976

APRIL 30

Going 'Mad' Over Money

Sharp Drop in IOS Stock Price Worries Investors, May Be Linked to Wall Street

By Neil Ulman
Staff Reporter of The Wall Street Journal

GENEVA — In an office looking out over Lake Leman and Mt. Blanc in the distance, a haggard official of Investors Overseas Services mutters grimly into a telephone in French, trying to squelch a rumor:

"No, no, no. That's ridiculous. Absolutely crazy," he declares, his voice hoarse, deep circles under red-rimmed eyes. The man has been at his phone all day long for the last week and a half issuing denials. "Bernard Cornfeld isn't dying of cancer. Top management hasn't resigned. There isn't any run on I.O.S. banks." And so on.

"Where do they get such ideas?" asks Harold Kaplan, the weary vice president and director of public relations for I.O.S. Ltd., the parent company for the huge international financial complex. "Where money is concerned," he sighs, "people go absolutely mad."

With I.O.S., which manages $2.3 billion of assets in mutual funds, real estate, banks and insurance companies operating throughout the Free World, money is very much concerned. And suddenly the many thousands of investors who have bought stock in the parent holding company, its fund management subsidiary or, in its mutual funds have every reason to be concerned for their money.

The stock of I.O.S. Ltd., which was offered last fall at $10 a share and traded as high as $19.75, was quoted yesterday in Geneva at $4.50 bid, $5 offered.

Shares of Investors Overseas Management Ltd., the 77%-owned subsidiary that manages more than $60 million of assets for the group's mutual funds, have plummeted from a high last spring of near $87 to $11 bid, $11.75 asked.

The funds they handle have, relatively speaking, fared better, or, more correctly, not so bad. The net asset value of Fund of Funds was listed yesterday at $20.55 a share, off 13.8% from the end of the first quarter a year ago. The net asset value of International Investment Trust yesterday was $7.46 a share, off 31.8% from the end of March 1969. In that same period, by comparison, the Dow Jones industrial average has dropped 21.2%.

There's little doubt, however, that rumors about the I.O.S. complex are jangling the nerves of some holders of I.O.S.-managed funds.

Americans are spared the anguish. None of the issues are registered with the Securities and Exchange Commission and none can be sold in the U.S. or to Americans overseas. But the tremors of discontent could rumble in the U.S., as well, since much of I.O.S.'s vast holdings are invested in American securities. Any precipitous selloff would severely intensify Wall Street's woes of late. Indeed, I.O.S.'s troubles may be a factor in the recent U.S. stock market decline.

'Disturbing' Elements

Ironically, I.O.S.'s troubles began not because the company is doing poorly, but because it isn't doing as well as its advance men had said. An I.O.S. official blandly dropped the bomb a few weeks ago. He said the parent company expected to report 1969 earnings of about $20 million, or 40 cents a share. That would be up from $14.4 million, or 31 cents a share, a year before. But it would be a far cry from the earnings of $30 million that some I.O.S. officials had been predicting last year.

With the bloom off the earnings rose, banks and brokers began to take a closer look at the company's operations and they unearthed what they considered some "disturbing" elements.

They noted, for example, that a Dec. 29 sale of arctic mineral exploitation permits by I.O.S.'s Fund of Funds and Growth Fund brought about a last-minute, dramatic improvement in their end-of-year performances.

Analysts, too, began to raise anew an I.O.S. underwriting of a Commonwealth United Corp. debenture issue of last summer that turned sour and the purchase of some of the securities by an I.O.S. fund.

They complained, further, of an intracompany sale on March 31 that transferred a Canadian mutual fund company from the parent to its management subsidiary. Some critics concluded the transaction put an unfairly low price on the management company's stock.

In the reassessment, down went I.O.S. shares, and along came more troubles.

As the price of the stock tumbled, many investors who had bought I.O.S. stock on margin, including some I.O.S. employes, were besieged by their bankers for additional cash. Pulling out the margin calls, among others, was Overseas Development Bank, I.O.S.'s Geneva-based bank, which had permitted some investors to put as little as 50% down.

With the calls, more shares were sold, and I.O.S. shares plunged even further.

First Big Setback

I.O.S., of course, has had plenty of losers for company during this general market decline. For I.O.S., however, this is the first big setback after a seemingly endless string of wins. "It's been a tempering experience for all of us," one official says.

Until now, the story of I.O.S. and its founder and chairman, Mr. Cornfeld, has been a tale of brash, seemingly unbounded expansion.

The former Brooklyn Eagle Scout and Philadelphia social worker began his financial career selling shares of Dreyfus Fund in Paris in 1956. In 1958, when French exchange controls began to pinch, he moved to Geneva. By 1960 he had incorporated I.O.S. By 1962 he had created Fund of Funds, a mutual fund that began by buying shares of other mutual funds, and International Investment Trust, still the two biggest I.O.S. funds.

But those were only the base. New funds were created to take advantage of differing tax laws in different nations. Highly trained and highly organized salesmen, working essentially on commission only, peddled the funds in investment programs tailored to meet the needs of investors of different lands.

For investors signing up for long-term programs, I.O.S. created insurance companies that guaranteed to pay the full amount of an investment plan in the event of a customer's death. For investors wishing to borrow money to buy I.O.S. fund shares, it created banks. When equity markets began to lose their luster, I.O.S. created vehicles for investing in real estate.

To propel the growth, I.O.S. staged lavish parties for its sales force. Cruises aboard a luxurious yacht in Geneva's Lake Leman were dangled as an extra inducement to success. Secretaries, file clerks and executives alike lunched elegantly at low prices in a mahogany-paneled, wall-to-wall carpeted reproduction of a fine Edwardian restaurant.

A Switch to Tourist Class

But now I.O.S. executives are being ordered to go tourist instead of first class, or phone or write if these will do.

The sales force, which was supposed to climb to 20,000 by the end of last year, is going to be trimmed from its 15,000 high of last summer to about 14,000 men. Some new supervisors recently brought over from the U.S. with their families and household goods have been told they aren't needed and are being shipped back home.

A spokesman talks of "drastic cost cutting, maybe cutting our expenses down from $60 million or $80 million to $40 million or $50 million."

Edward M. Oswell, president and chief operating officer, tells I.O.S. fund managers the company is de-emphasizing the "super stars," those independent analysts who were entrusted portions of fund assets and rewarded on the basis of short-term performance.

In their place, says another company executive, "we're bringing in mature, thoughtful fund managers, no more swingers." There, too, there will be more research. But company officials are reluctant to say just how many "prudent managers are being hired, just how much more in-house research will be performed.

Despite its problems, insists a spokesman, "our company is sound."

To the bearded Mr. Cornfeld, "ugly and ill-founded rumors" are responsible for the sharp decline of I.O.S. stock. He points specifically to "German banks which sell mutual funds in competition with I.O.S." He charges they have been advising their clients to shun I.O.S. offerings and take the bank shares, instead.

West German bankers, for their part, are especially incensed about allegations that they are selling I.O.S. shares short, that is, selling borrowed stock now in hopes of replacing it later when the market is lower. "Nonsense," scoffs an executive of Deutsche Bank AG in Frankfurt. A Dresdner Bank AG official proclaims, "West German banks aren't allowed to make short sales."

"Something to Think About"

Mr. Cornfeld, in defending I.O.S. operations, allows the company's earnings haven't lived up to advance expectations. Still, he says, the com- y will report 1969 earnings "very comfortable ... / up" from the year before. "Nearly every fund management company in the U.S. is losing money. We're making money. That's something to think about," he declares.

He concedes, though, "We're in a profit squeeze, a problem we never really had before." And he explains that when "an organization is only going in one direction, up, sometimes certain costs may be overlooked. Now that we see the problem, we're doing a lot of cost cutting," he says.

I.O.S. emphatically denies that the squeeze on profits has produced a squeeze on cash. As of earlier this week, a spokesman says, fully 40% of the Fund of Funds' $800 million of assets was held in cash. Of International Investment Trust's $691 million of assets, 20% was in cash. For the complex overall, about $700 million, or almost one-third of total assets, was in interest-bearing cash deposits "by deliberate policy," the company says. I.O.S. wouldn't comment on the liquidity of its unmeash assets.

I.O.S. says further that, with all the adverse publicity, its funds managed to sell more shares than they redeemed in the first 14 days of the month. The gross cash inflow for the first half of April was put at $50.5 million, when redemptions totaled $34.9 million, giving the funds a net cash inflow for the period of about $11.4 million.

If the pattern were extended for the full month, though, this would indicate a net inflow for April of about $23 million. That would be down from an average monthly inflow of $30.9 million in the first quarter. And it would extend a decline that has been crimping I.O.S. operations for months. From a quarterly high of $313 million in the second period last year, fund net cash inflow slipped to $120 million in the third quarter, $130 million in last year's final quarter and $108 million in the first quarter this year.

Still, insists an I.O.S. official, "this isn't a leverage company. We haven't any debt. On the contrary, we have working capital we're seeking to invest. We're a lot less vulnerable to a business slowdown than companies that might hurriedly be called upon to pay off loans."

I.O.S. also rejects as "ridiculous" rumors that the company's banks are in trouble. An official, however, is unable to produce statements of condition for Orbis Bank, I.O.S.'s 60%-owned German bank, or Banca Provinciale di Depositi e Sconti, the 80%-owned Italian operation. For Overseas Development Bank, he provides a year-end statement showing $97 million in deposits, $20.6 million of "current accounts with debit balances" and $17.3 million of "fixed advances and loans." The spokesman says there hasn't been any "substantial change" since year-end.

As for the clouds over I.O.S. operations, the company has some explanations.

The sale of Arctic exploitation rights, the company says, was timed for tax reasons involved in the sale itself and had nothing to do with any desire for a last-minute boost in fund assets.

The two I.O.S. funds, the company says, last June acquired a 50% interest in mineral exploitation rights on 20 million acres of Arctic territory east of the North Slope. They bought the interest from King Resources, a company in which, not so incidentally, I.O.S. funds had large positions. After bidding for North Slope leases had pushed up the value of these rights in the early autumn, I.O.S. says, it got an offer from oil interests, including a large U.S. oil company, to buy 50% of the I.O.S. funds' 50% stake.

The company denied that I.O.S. changed its mind to sell its interests in the same year it bought them. So King Resources in December sold the oil group an identical 50% interest at 10 times the price I.O.S. had paid for the shares. On that basis the I.O.S. fund holdings were revalued upward. Then I.O.S. actually sold its 50% interest to King Resources in January in what amounted to a "wash" or flow-through transaction for King Resources.

That the timing just happened to push up the per-share asset value of the two I.O.S. funds just before year-end was sheer coincidence, I.O.S. says.

Explanation for Intracompany Sale

I.O.S. also has a ready explanation for the intracompany sale of Canadian Channing Corp. "It never occurred to us" that the public would think it was valuing the I.O.S. Management's shares under the market when I.O.S. Ltd. took 600,000 of the management company's shares for a property it had bought the day before for $7 million. Although this seemed to indicate that I.O.S. valued the shares at $17.50 each when they were selling in the open market at $33 a share, it wasn't so, I.O.S. insists.

The 600,000-share price was arrived at through a formula designed to neither dilute nor give an undue increase to the management company's earnings from the acquisition of Channing. It had nothing to do with the market value of the management company's stock, I.O.S. officials say.

Mr. Cornfeld didn't have any ready explana-

tions for I.O.S.'s two ventures into corporate underwriting last year: A $20 million convertible debenture issue for Gilfen International N.V., of which International Investment Trust acquired $7.5 million, and a $20 million convertible debenture issue by Commonwealth United, in which International Investment Trust took a $7.5 million stake. By last week, those Gilfen debentures were quoted on the open market at half their face value. The trust by year-end had listed its Commonwealth United holdings at well under half the purchase price.

"We probably won't be managing any new issues in the future," says Mr. Cornfeld.

APPENDIX E

EXCERPTS FROM TRANSCRIPTS OF HEARINGS CONDUCTED BY TRIAL COURT, JULY 22-23, 1976

E-1. July 22, 1976

[COUNSEL FOR ANDERSEN]: Your Honor, we filed the response to the interrogatories, as to why the interrogatories couldn't be answered, where we have a problem that we are trying to overcome, but those were also served this morning.

THE COURT: Were these interrogatories as a result of this Court's order of the 26th of May?

[SECOND COUNSEL FOR ANDERSEN]: Yes, those are the interrogatories—

[COUNSEL FOR ANDERSEN]: Those are the interrogatories that are the subject of that order.

THE COURT: And your statement to the Court is that substantially these have been responded to today with several narrow issues?

[SECOND COUNSEL FOR ANDERSEN]: One area.

[COUNSEL FOR ANDERSEN]: One small area of information that we have had difficulty because of the Swiss legal problems answering. It's been identified in the answers to interrogatories.

THE COURT: Why weren't they answered before today?

[COUNSEL FOR ANDERSEN]: The same problem. We wanted them to be covered by the protective order and we now would agree with Plain-

tiff's attorney's position on that that we were in error on that and that it was not necessary to have the protective order.

E-2. July 22, 1976

THE COURT: I'm satisfied on these non-privileged documents that [Counsel for Andersen], who is familiar with the orders of this Court and the rules in the United States under discovery, could have brought many of these documents with him without any question through Customs, without security, without any other exigencies, without any impediments, and without any delay of having to have these documents clear Customs several weeks before and additional delay.

Now, I would like you to respond to this question: What was your understanding, please, when these documents were to be submitted to Counsel under the Court's order?

[COUNSEL FOR ANDERSEN]: Going back and operating at this point, Your Honor, under the May 26th order, we — and at that time there wasn't really any schedule, as we understood it, other than we were going to make our best efforts, and I recognize now in retrospect in view of the creation of all this confusion and the firing of papers back and forth, I really wish that we had done that, but at the time I was not focusing on it as being a problem.

E-3. July 23, 1976

THE COURT: I sense Counsel's argument is that Arthur Andersen has been the editor. They decided, well, we are going to pick and choose.

[COUNSEL FOR ANDERSEN]: That's true.

THE COURT: And we are going to delete, even though there's been no adjudication by the Court or there's been no protective order or anything—we are going to determine what we are going to surrender up and what we are not [going to] surrender up, and I think that was the argument yesterday, and I think that's [Counsel for Ohio's] argument today is that the editor has been Arthur Andersen instead of the Court.

APPENDIX F

ORDER OF UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT DENYING ANDERSEN'S MOTION FOR STAY OF MANDATE, JANUARY 7, 1977

NOVEMBER TERM—JANUARY 7, 1977

Before Honorable David T. Lewis, Chief Judge, Honorable Jean S. Breitenstein, Senior Judge, and Honorable William E. Doyle, Circuit Judge.

ARTHUR ANDERSEN & CO., Petitioner, vs. HONORABLE SHERMAN G. FINESILVER, etc., et al., Respondents.	No. 76-1618

PETITION FOR
WRIT OF MANDAMUS
(D.C. No. C-4628)

STATE OF OHIO, Plaintiff-Appellee, vs. ARTHUR ANDERSEN & CO., Defendant-Appellant.	No. 76-1632 76-1633 and 76-1710

This matter comes on for consideration of the appellant Arthur Andersen and Company's motion for stay of mandate pending application to the Supreme Court for Writ of Certiorari. The Court has ordered and received responses by the opponents of record and has considered them.

Upon consideration whereof, it is the order of the Court as follows: Andersen's motion for stay of mandate is denied. The issue relates to an interlocutory discovery order. No sanction has been imposed for non-compliance. The case has been pending since April, 1972, and should go forward.

/s/

HOWARD K. PHILLIPS
Clerk